

External Finance and Debt - A Thematic Outline

Uses/Magnitudes

A. Achieve Overall External Balance

- Minimum Imports (Visible and Invisible)
Consistent Operation Economy Present
Level/Achieve 4% to 6% Growth

plus

- Actual External Debt Service

minus

- Attainable Exports (Visible and Invisible)

B. Stabilise/Adjust Overall Resource Position

- Minimum Efficient Public Services Plus Public Infrastructure
(Recurrent and Capital) - Bank LTPS estimate 30 to 35% of GDP (well
above typical present ratio)

plus

- Enterprise Investment

less

- Recurrent Domestic Public Revenue
- Enterprise/Household Cash Flow On Depreciation
- Enterprise/Household Savings

Note - if economy is severely import constrained ex post domestic savings plus depreciation cannot exceed domestic content of gross investment. For fixed investment in SSA, national average direct and indirect import content in 50% to 67% range.

Note - for 6% growth requisite gross fixed investment likely to be of order:

Depreciation At	
3 to 4% Capital Stock	10% GDP
Net Current Investment - say	
2.5 to 3 times growth	
GDP	<u>15-18%</u>
Fixed Investment Needed	<u>25-28%</u>

- Real Working Capital - stocks of raw materials, goods in process, finished goods plus tools and spares must rise if fixed assets are to be used. Rough estimate of stock would be 25% to 33% GDP so for 6% increase require 1.5% to 2%.

C. Schematic Summary Requirements (All %'s to GDP)

<u>Total</u>	Public Services (Recurrent)	20-22½%
	Public Services (Infra-structure (Capital)	10-15%
	Other Fixed Investment	12-18%
	Working Capital (Real)	3%
Public Services/Investment Requirement		<u>47½-50%</u>
Of Which Import Content		
	Public Services (Recurrent)	5%
	Fixed Investment	15-20%
	Real Working Capital	1½%
PS/I Import Content		<u>22-25%</u>

D. Schematic Summary Balances/External Finance

Domestic Revenue Government	15-20%
Enterprise/Household	
Depreciation	5-7%
Savings	8-12%
Total	<u>28-39%</u>
<u>Gap (Overall Resources)</u>	<u>10-20%</u>
Visible/Invisible Exports	20-30%
Visible/Invisible Import Requirement	
▪ Public Services/Investment	22-25%
▪ Other	<u>12-17%</u>
External Debt Service	<u>5-10%</u>
Total	<u>40-50%</u>
<u>Gap (External Balance)</u>	<u>20%</u>

(These figures are schematic. The "Most affected" economies have larger ones.)

Stabs/Saps - Problems of Successes in Own TermsA. Stabs (Stabilisation Programmes)

Budgetary Balance narrowed to net domestic bank borrowing level approaching 0. I.e., plugged external grants/soft loans

External Balance reduced to stability/rise reserves and stability/fall debt service arrears and external hard loan with external grants/soft loans plus debt service deferral (or write-off) plugging gap.

Neither is orthodox because neither can be assumed to be sustainable. But in typical SSA stab case attempting orthodox closure would effectively end public services and investment and (if 'sustained') lead to 'balance' not simply at much lower GDP level but on falling trend.

B. Saps (Structural Adjustment Programme)

Successes do raise output-exports-domestic revenue-capacity utilisation-investment-savings and (less clearly) consumption per capita, "efficiency".

Do not significantly improve (nor address) poverty reduction.

Do not produce falling savings or current account deficits on trends which restore balance at low grant/soft loan levels. (See LTPS.) Indeed usually 5 year projections "success" cases show constant absolute savings/external gaps (admittedly fall relative to GDP) and structural recovery's continuation to be dependent on their being plugged externally.

This is not original SAP concept nor rhetoric of Accelerated Development. But given necessity GDP growth above that of population from Year 2 or 3 of Stab/Sap, if those are to be domestically sustainable, versus possible export growth and "efficient import substitution" growth (structural rigidities, non-shiftable resource, terms of trade, market physical growth constraints) Bank sees no actual alternative but to slide forward external gap narrowing goal if in other aspects Sap economy is progressing successfully.

Basic Issues of External Financing

A. Adequacy - Quantitative

(Relative to targets for recipient economy or supplying agencies -

- The formulation in first section is one set of targets but not all recipients/agencies share it and it may for whole of SSA breach feasible supply constraint)

B. Adequacy - Qualitative

- Relevant to key constraints (e.g. a 1998 dam does not reduce a 1990 fertiliser shortage)?
- Smoothly flowing (e.g. if commitment is import support for sale/counterpart funds to basic services, do procurement-sales-recoveries-transfers-expenditures actually happen and - if so - expeditiously?
- Engaging with key production sectors including exports/efficient import substitutes in household/enterprise sectors? (Results suggest not except for traditional export rehabilitation.)

C. Adequacy - Sustainability/Predictability

- 3 Years Rising/7 to 12 Constant (Real Terms) likely parameters success (e.g. Ghana 1983-1998)
- For budgeting efficiency need 3 year rolling frames of
 - a. commitments
 - b. disbursements
 Overall and By Type/Sector

D. Adequacy - Terms

- Bottom Line (net inflow) key
- If interest/repayment high, this raises inflow needed now and in future
- If severe "debt distress" (external and/or budgetary) logical case (administrative ease if nothing else) is high proportion grants/very soft loans
- Reinforces need to do Overall External Resource Sources/Needs Projections including External Debt Service

Variations and Implications

A. Key Constraint(s)

External Balance (e.g. Ghana)
 External Debt Service (e.g. Nigeria)
 Domestic Savings Potential (e.g. Burkina)
 2 or More (e.g. Sierra Leone)
 None of Above (e.g. only e.g. in SSA-Botswana)

B. Time Frame for Reduction

Potentially Short (e.g. Namibia, Zimbabwe)
 Medium Term Potential (e.g. Ghana)
 Long Haul (e.g. Tanzania, Mozambique)
 No Projection Possible (e.g. Sierra Leone, Zambia, Sudan)

C. Finance Types

Grants

Very Soft Loans (can build up severe external debt service burdens in long haul cases, e.g. IDA in Mozambique, Tanzania and presumptively Zambia, Sudan)

Guaranteed Export Credits

For Botswana OK

Selective Use Quick Forex Earning/Saving Projects and Quick Gap Filling

Market/Near Market Bank Interest Rate Loans - Long (15 years plus) Term

Potentially Usable Nigeria's, Angola's
 Same Problems as GEX

Market/Near Market (IMF except SAF/ESAF)

Medium - Short Term

Genuinely Revolving 90-18 Day Trade Credit
 Highly Desirable to Use/Restore

Other Unsuitable except as bridge to assured longer/softer

Exception Genuinely/Predictably Short Term Shock Response (e.g. Botswana mid-80s shock)

Conditionality

A. Doing Some Good

- For Recipient
- For Donor

(in mutually acceptable ways)

B. Variations By Type

- Humanitarian (access/channel to poor or starving only appropriate conditions)
- Selected Project (ability to function/moderate limits all leakages needed)
- Import Support (keep economy/public services functioning/time for serious strategy for adjustment-recovery. Implicitly belief such a strategy is being canvassed seriously.)
- Programme/Macro Support Package (plausible strategy-commitment-efficiency-governance)
- Sudden Non-Life Threatening Shock Relief (Analogous to Import Support)

C. How Formulate/Link Conditions

- Steps To Be Taken For Finance (E.g. IMF Pre-Conditions and phased or "trigger clauses"); or
- Finance To Support Steps Already Initiated (this approach more compatible building domestic base for strategy transformation and for developing African Institutional capacity)?
- Evaluation On Basis Action Attempted; or
- Basis Results Achieved?

(problematic because formal actions unequal to serious, coherent effort. But results can be largely exogenous - e.g. war in Mozambique, drought in Malawi, cocoa price in Ghana determined at least in short run.)

Moral risk - high short run domestic cost action pushed by resource providers taken but no results, or horrendous side effects. What is adviser/funder 'obligation'?)

Particular Problematics

A. Projectitis

- Ease of Presentation
- Limitations in Absence Programme Support

- Failure to Consider Post Investment and Break In Period Sustainability (Maintenance and Operation Cost, Technology, Personnel)
- High Import Content (Inherent, ease of specification, donor habit - interest - bias)
- Creation Imbalances Sectorally and Capacity/Bottleneck/Usable Capacity Contradictions

B. Balance

- New Projects
- Rehabilitation (Deferred Maintenance) Projects
- Maintenance (including Institutional/Personnel Capacity Building)
- Programme (including Import Support)
- Humanitarian/Emergency (including livelihood rehabilitation of displaced persons-refugees)

C. Enterprise

- Limits Government Capacity Conceptualise/Design/Run (both funder and recipient side)
- Limits Private Fund Suitability
 - Initial Cost Profile
 - Projected External Balance Profile
- Limits Private Fund Availability
 - "Climate" within Recipient State Control
 - Market Buoyancy (absence limits probable profits)
 - Forex Availability Constraints Hamper Production - Maintenance - Interest, Royalty, Fee, Profit Remittances (Latter two not withing recipient - or if LTPS correct anybody's - control)
- Possibility Mixed Funding
 - Enterprise Knowledge/Personnel
 - Part Enterprise Capital/Risk
 - Part Funding Government Loan To Enterprise
 - Part (defined) Special Risk Insurance Government to Enterprise

D. Accountability

- What data needed
 - e.g. in programme support how much on specific input/how much programme results overall? Does it matter whose basic drugs went where if overall clinic drug supply restored and wastage/'leakage' rates acceptably low?
- In What Form
 - Funder Frame
 - National Frame of Recipient
 - Both

- Snag To Funder Frame
 - Not Uniform
 - Not Same As National Frame
 - Seriously Weaken/Deter Development of National Accounting-Transparency-Efficiency Analysis-Accountability To Civil Society Systems
- Possible Route
 - Strengthen National Systems
 - Require Reports in Their Terms (with limited side data)
 - Funder Transpose Reports into Own Format (has far more personnel/electronic processing capacity)

External Debt

A. Levels (Stock/Service Flows)

- SSA Small Relative To World Totals
- Regionally Highest Relative To GDP/Exports in SSA
- Default/Arrears Levels Highest (relative to stocks/flows) in SSA

B. Makeup

- Uneven (handful commercial/export credit - larger number mixed - majority governmental and international financial institution)
- Virtually All Government Borrowed or Government (including Government Owned Financial Institution Guaranteed)

C. Estimate

- Long/Medium Term Nearing Acceptable Levels Accuracy (Requires Crisis/Rescheduling Effort -)
- Short Term Serviced/Revolving Underestimate (short term commercial at least until 1980s higher share SSA than globally?)
- Short Term non-guaranteed/non-financial enterprises very weak estimates

D. Writeoffs/Reschedulings

- Pragmatic Goals
 - Get most Back On Old Debt
 - Get Most Combined Back On Old Debt plus
 - Gains New Transactions (including non-monetary gains, e.g. reduction poverty, domestic-regional-global stability, avoidance deaths, development)
 - Second Usually More Rational Lender/More Desirable Borrower

- In Context of Necessary (Net) Finance to Achieve Goals
i.e., Is delaying payments adequate?
How long?
Or must they also be reduced in present value terms?
How much?

E. Category By Category?

- Near Total Write-off, e.g. Mozambique/Tanzania
contingently Sudan/Uganda/Sierra Leone
- Over 50% Write-off, e.g. Malawi/Ghana(?)
contingently Zambia/Swaziland
- Significant Write-off, e.g. Kenya/Nigeria/Ghana(?)
(special problem because of makeup) contingently Cote d'Ivoire
- Basically Major Rescheduling, e.g. Zimbabwe/Cameroon
contingently (?) Angola
- Not Present Problem, e.g. Botswana/Namibia (first because of economies strength and second because of limited present external debt)

F. Write-off By Rescheduling

- Grace Period/Long Repayment plus Low Interest Does Constitute Partial Write-off (e.g. 10 year deferral at 2%, 20 years to repay at 3% constitutes over 80% real write-off)
- For "Significant" Write-off Cases Can Handle By Such Reschedulings
- For "Over 50%" Write-off Cases Bizarre As Sole Instrument, as well as unsuitable (on those terms) for Private Debt
- For "Near Total" Write-off Either Unworkable or Hardly Plausible
(Defer All Payments 1990-2010 with 1% interest - repay 2011-2050 with 1½% interest might be adequate if all new finance grant plus 10 plus 25 years at 1%.)

G. Write-off By Sleight Of Hand

- Cash Transfer To Meet Debt Service (occasionally provided/more frequently canvassed including by IFI's)
- Import Support To Cover Virtually All Imports so Very High % Export Proceeds Can 'Service Debt' (e.g. Mozambique Debt Service - to Fund/Bank, occasionally commercial banks - 45% Visible and Invisible Exports plus Migrant Worker Remittances net of exporter retention allowances. About 90% visible/invisible imports externally financed)
- When, why, how long, how much of this desirable, practicable, sustainable? Is it efficient for resource transferor or recipient?

Modalities By Type Of Lender

A. Paris Club

- Reschedule Arrears plus 5 years or All 1990s Payments On Pre-1990 Debt (in full or in part) In One Go
- Terms Up To 10 Years Grace at 1 or 2% On Balance Plus 20 Years To Repay At 2 or 3% (75-85% write-off at those terms)
- Include Government Guaranteed Export Credits. (Pragmatic reasons plus nature most initial transactions as export boosting/resource transferor enterprise assisting.)
- Why 5 to 10 Years Payments at One Rescheduling?

Opportunity Cost To Recipient

(up to 15% senior finance personnel time devoted to near charade - nobody expects money to "come back" in real sense)

Desirability Projectable/Predictable Frame for Resource Requirement/Source Modelling

Does Not Reduce "Conditionality" because High Write-off Cases all need New Resource Inflows too

Improves Climate New Private Investment and Short Term Trade Credit

B. Commercial Banks - Medium and Long Term and Long 'Stuck' Revolving Credits

- Buyback at £.10 to £.25 on the £ (of principal or principal and accrued interest); albeit in "50%" or "Significant" write-off cases rescheduling plus fixed (say 8%) interest plus 20% to 50% write-off might be adequate and prudent.
- Banks have written down these loans (net of reserves) 50 to 80% on own books and do sell at very low prices
- Absurd to 'expect' to get 100% back ever and/or to push whole write-off burden on governments
- Government or IFI soft loan or grant finance for buyback schemes (analogous to Bolivia Nordic/Netherlands commercial bank buyout and to Brady Plan plus)

Can be used as source counterpart funds but usability such funds may be constrained by inflation risk especially if boughtback debt was not being serviced so was overhang against future, not leakage of present, resources.

C. Commercial Banks - Revolving Commercial Credit

- Working Capital of Trade - inaccessibility raise forex tied up prepayment imports and pipeline export receipts coming

- Priority For Restoration
- Separable From Medium-Long Term and Long 'Frozen Up' Revolving Lines (Commercial Banks' practice bears this out.)
- Possible Uses ESAF?

Clear Minor Arrears 90-180 Day Credit

Hold Portion ESAF Drawing to Guarantee New/Continuing Credit Lines

D. Non Guaranteed/Non-Bank Supplier Claims Arrears
(Very substantial Nigeria and Francophonia. Significant Zambia and probably Sudan.)

- Not suitable long term/low interest rescheduling (recipients wouldn't want to hold that kind of paper and not very marketable. Perceived cost to issuer above perceived value to recipient.)
- Commercial/Producer/Construction Firms have long since written most off and often 'recovered' by higher prices on subsequent cash in advance (or guaranteed export credit) transactions except perhaps for less evidently - in past - weak Francophone economies (notably Cote d'Ivoire)
- Buyback at £.1 to £.25 on initial payment due (analogous to Commercial Bank) case backed by grant/soft loan external funding least implausible approach. (No debtor not in "Significant" or higher write-off category has substantial arrears of this kind. The levels in Cote d'Ivoire/Senegal are likely to be very nasty surprises as both governments 'hid' external arrears not by blocking remittance of CFA payments which they could not do but by delaying CFA payments due foreign suppliers and contractors. This overhang has been seen and cited since mid-1980s by some observers who doubted apparent better fiscal/financial health of CFA economies/states. Not paying bills domestically is an alternative to borrowing from Central Bank in local currency and 'paying' but not remitting. It is almost more dangerous because it is less transparent as to overhang and delays appearance of inflationary/smuggling rise warning symptoms associated with open imbalances/arrears. An analogous problem exists domestically, e.g. Benin on paper has much higher real public service salaries and allowances than Tanzania or Kenya and does have less bank finance outstanding relative to revenue. But for bulk of public service it has built up 4 to 6 month salary arrears and has from time to time had 'voluntary' writedown - partial payment - special 'savings' schemes. Less transparent fiscal problem plus apparent - but unclear as to reality - high public sector wage problems versus transparent fiscal and actual low real public sector wage problems is not necessarily lesser or more easily resolved overall problem.)

E. IMF

- For Structural Adjustment/Transformation 7% to 8%, 3 to 8 year money is totally unsuitable. (Just think what the reaction would be if Tanzania proposed to borrow \$200 million at 8%, 3 years grace plus 5 to repay from any other source. Yet it has been urged to do that with IMF - and has wisely declined to use anything like that volume.)

- Therefore ESAF (1% - 10 year) should be used to:
 - i) roll over existing shorter term/higher interest drawings
 - ii) provide any net new IMF credit for supporting saps/transformation strategies
- But consider problem no SSA state (except Botswana) can call on IMF funds for their basic intended purpose:
 - i) short term crisis filling/bridging (when gap is self-correcting or can be corrected within 3 years and is - say - 1 to 3% GDP)
 - ii) rapidly, readily accessible (Zimbabwe's mid-1980s idea of repaying IMF in full and using other sources for long term finance to have first two IMF tranches available to cover short term crises superimposed on longer term problems was notably ill received by IFI's main bilateral resource sources.)

World Bank/IDA

- A. Convert past Bank window loans of "50%" write-off and above categories to IDA. (Partially done or in progress.)
- B. In crisis situations or in one-off shock cases provide 1 to 3 year access to IDA for countries normally on "Bank terms", e.g. Namibia 1990-93, perhaps Cote d'Ivoire 1990-93. (Precedent Zimbabwe 1980-81.)
- C. Mobilise additional (not out of basic IDA commitments) resources to finance such conversions/broadening of IDA access.
- D. Have target of net inflow/transfer level (not just gross) for any SSA IDA or Mixed country.
- E. In extreme cases (especially restarts from past collapses) mobilise third party resources to redeem arrears and possibly make part of service payments on pre-new start loans for a limited period. (Relevant Zambia and contingently Sudan.)

Regional Development Banks (e.g. Afdevbank)

- A. Logically Analogous To World Bank/IDA
- B. Require Additional External Funding To Convert "bank" to "fund" window retrospectively
- C. Need To Consider Making Poorest Members Purely 'Fund' Window Borrowers (or become very unattractive source for IDA/Grant recipient group)

Enterprise Investors (including IFC-CDC)

A. Convert Portion Existing Loans

To Preference Or Ordinary Equity
 Defers Payments Until Profits Earned
 Increases Chances Enterprise Recovery
 Recognises Limits Present Remittability

("If earned" - "income note" - or "payable if earned - cumulative as to balance" instruments might also serve if principal repayment was deferred until all interest had been earned or for phased repayment interest was current. These would not improve look of balance sheet debt/equity ratios but would have comparable cash flow gains to and raise less taxation issues than, equitisation.)

B. Ensure bearable (enterprise and economy) payment profiles for additional/new investments

Higher Equity Share (remittances only if/when earned and likely to begin later and lower than interest)

Greater Use of Payable When/If earned debt instruments

Greater Use of Interest Capitalisation for early years of new venture/major expansion

C. Higher share of risk on external partner. (Same instruments as last section.) Maximum incentive to perform and to stick it out.

(If equity stake low and substantial portion recovered in construction/early operating year fees and charges while debt recipient and lending state government guaranteed external investor has little risk and relatively low incentive to stick out long haul, difficult recovery.)

D. These points increase case for transferor government loans to enterprises for part of such investments and for risk sharing against specified "abnormal" adjustment/recovery political and exogenous (to enterprise) economic risks on a specified basis.

(The above schema is based on SSA but is also relevant to other low/lower middle income economies, e.g. Philippines, Fiji, Papua-New Guinea, Burma, Nepal, Afghanistan, Morocco, Jamaica, Dominican Republic, Haiti, Guatemala, Honduras, Nicaragua, Paraguay, Bolivia, probably Peru, Ecuador.)



R. H. Green
 Lewes
 May 1990